

*TOUCHE-ROSS  
REPORT*

Mr. William E. Colby  
Director, Central Intelligence  
Washington, D.C. 20505

Dear Mr. Colby:

We are pleased to submit to you a report of our review of the Agency's internal audit functions. Our review was conducted in accordance with our proposal dated October 9, 1973, and the provisions of contract XG-3882(1201-AS-5)74P, dated October 15, 1973.

Very truly yours,

TABLE OF CONTENTS

	Page
I. HIGHLIGHTS . . . . .	2
II. BACKGROUND . . . . .	3
III. SCOPE . . . . .	7
IV. SUMMARY . . . . .	11
V. NOTEWORTHY ORGANIZATIONAL AND OPERATIONAL ELEMENTS OF THE CIA AUDIT STAFF . . . . .	13
VI. OPPORTUNITIES FOR IMPROVING CIA AUDIT POLICIES AND OPERATIONS . . . . .	18
VII. COMMERCIAL SYSTEMS AND AUDIT DIVISION, OFFICE OF FINANCE . . . . .	25

## Appendices

I. TECHNICAL COMMENTS AND RECOMMENDATIONS FOR AUDIT STAFF PRACTICE . . . . .	29
II. TECHNICAL COMMENTS AND RECOMMENDATIONS FOR CSAD PRACTICE . . . . .	35
III. TOUCHE ROSS AND CO. PROPOSAL, OCTOBER 9, 1973	
IV. CONTRACT XG-3882(1201-AS-5)74P, OCTOBER 15, 1973	

## HIGHLIGHTS

The results of our review of internal auditing in the CIA are presented in detail in the following report. Some of our conclusions include:

- the overall internal audit effort in CIA is adequate to safeguard Agency assets and ensure administrative compliance with laws and regulations.
- Agency auditors are generally well-qualified, well-trained, professionally competent and, for the present, adequate in numbers.
- to conform to overall federal policy, and to more effectively use the audit resources available, Agency management should encourage broader audit coverage of the economy, efficiency and effectiveness with which its programs are carried out, and consider modifying its policy requiring annual financial audit of all activities.
- Agency management should capitalize on a ready source of management talent by considering upper level auditors for management positions in operational areas.
- articulated quality assurance policies, would help to maintain high standards for audit performance.
- continued operation of the Audit Staff covert public accounting firm may become uneconomic if changes are made in the Agency audit policy.
- the Commercial Systems and Audit Division may be able to shift the emphasis of its audits somewhat to provide more useful information to procurement personnel.

# BACKGROUND

Two related factors directly affect the character of the CIA internal audit function. The first is the Central Intelligence Act of 1949, which grants the Director of Central Intelligence (DCI) the authority to expend sums made available to the Agency over his certification that such expenditures are of a confidential, extraordinary, or emergency nature, without regard to the provisions of law and regulations which normally apply to the expenditure of government funds. Thus, the DCI can authorize any expenditure so classified regardless of the rules which might normally apply to other federal agencies.

The combination of these two factors resulted in a strong desire on the part of early Agency management to establish with the Congress a baseline of confidence in the integrity of the fiscal operation of the Agency. Agency management believed that the special operating practices, though necessary, would be difficult to retain if substantial financial improprieties occurred. Therefore, they insisted on financial audits of every Agency expenditure every year in the belief that such audits would help insure financial propriety and would be a convincing item to point to in Congressional hearings.

Until 1962, the General Accounting Office, as an oversight Agency for Congress, conducted audits of some CIA activities, particularly those relating to the "vouchered" overt expenditures. In June of 1962, after a period of confrontation and negotiation, GAO ceased all its CIA audit activities because the Comptroller General did not believe his staff had sufficient access to effectively accomplish its audit objectives. GAO believed its purpose was to determine how well the Agency or activity under audit had accomplished the purposes it was authorized to accomplish through efficient and economical use of funds, people and property and that it needed access to information about all CIA operations in order to do so. The Director of the CIA, on the other hand, believed the Congress intended to exempt the CIA's confidential funds from all review, and that to permit GAO to conduct a "comprehensive" audit would compromise the necessary operational security. As a result of GAO's withdrawal from all auditing of CIA operations, the CIA Audit Staff assumed final audit respon-

sibility for all CIA activities and funds.

The current CIA audit policy states that the Chief, Audit Staff is responsible for performing final independent audits annually, or as often as he deems necessary, of all Agency activities, including headquarters components, proprietary and other projects, domestic and overseas field stations, and all Agency-sponsored activities, such as the Federal Credit Union or employee health and insurance plans. The policy requires audit procedures necessary to (1) ascertain that controls and records are adequate to assure proper safeguarding, use of, and accounting for Agency assets; and (2) verify compliance with applicable law, policies, regulations, and procedures. The Chief, Audit Staff is required to report any Agency activities found, as a result of audit, to be uneconomical, inefficient, or improper.

\* Present internal audit practices developed then, in an environment that demanded annual financial audit of every Agency activity and in which oversight evaluation by the General Accounting Office was limited or non-existent. Audit plans, programs and procedures were all developed with the goal of ensuring complete annual coverage of financial activities of all organizational elements. Limited emphasis was given to matters of Agency efficiency and economy, and no audits specifically of program effectiveness were conducted prior to late 1973.

Agency audit functions are performed by two separate organizations; the Inspector General Audit Staff, and the Commercial Systems and Audit Division, Office of Finance. The Inspector General Audit Staff performs a "post-audit" function for all Agency activities, whereas Commercial Systems and Audit Division audits are part of the procurement process, providing information about the accuracy of direct costs charged to Agency contracts. More detailed explanations of the functions of each group are contained in later sections of this report.

25X1A { The Inspector General Audit Staff (hereinafter referred to as the Audit Staff) is currently authorized positions for 39 professional auditors and 6 secretaries. Organizationally, the Audit Staff is part of the Inspector General's staff and reports through him to the Director of Central Intelligence. In calendar year 1972, the Audit Staff issued 265 reports covering the audit of 131 headquarters and [REDACTED] overseas activities and stated it had either audited or was in the process of auditing all Agency activities. (Our comparison of Audit Staff audit coverage with the CIA financial report provided us by the Chief, Audit Staff, indicated the Audit Staff audits did include substantially all Agency activities.)

The following analysis illustrates the Audit Staff workload for fiscal year 1974.

Directorate	FY 74		Appropriated Funds and Advances from Other Agencies, FY 73	
	Man Days	Per-cent		Per-cent
Operations . . . . .	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Support . . . . .				
Science and Technology				
Intelligence . . . . .				
Office of Director .				
				100.0
Non-appropriated Funds	[REDACTED]	[REDACTED]	25X1A	25X1A
Support (Credit Union, GEHA, etc.) . . . .			-	-
Total . . . . .			25X1A	100.0

The analysis shows that the Audit Staff workload is roughly proportional to overall Agency expenditures other than Science and Technology expenditures. Such expenditures amounted to [REDACTED] of the total dollars audited and 11.3 percent of the Audit Staff man-days available. This is explained in part, by the Audit Staff's orientation toward auditing each point of expenditure regardless of the amounts involved and in part by the large dollar volume of the individual contracts that represent the bulk of Science and Technology expenditures.

The Audit Staff is organized into three functional groups related to the overall Agency organization as illustrated on the following page. This organization is designed to provide optimum communication between the Audit Staff and the organizations subject to audit.

#### Commercial Systems and Audit Division

The other audit organization within CIA is a division of the Office of Finance which does interim and final audits of all the Agency's negotiated contracts other than [REDACTED]. CSAD consists of 29 cost auditors and 5 administrative employees, and audited [REDACTED] contractors during fiscal year 1973. CSAD audits direct materials and labor costs for contracts at least once prior to final payment.

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## SCOPE

Our review was undertaken at the request of the Agency, to determine whether the overall audit process within the Central Intelligence Agency is adequate. Our understanding of the standard to be applied in determining "adequacy," is that it is that amount of audit necessary to achieve results comparable to those that would be achieved if the Agency were subject to audit by a central audit authority. To accomplish our objective we reviewed:

- (a) internal auditing standards for federal agencies as promulgated by the General Services Administration Office of Federal Management Policy, the Office of Management and Budget, and the United States General Accounting Office.
- (b) CIA audit policies in the light of authorizing legislation and as stated in implementing regulations.
- (c) the scope of audit activities actually carried out within the Agency including (1) the programs followed; (2) the evidence-collection and summarization techniques in use; (3) the reporting practices followed; and (4) other aspects of technical performance as we considered necessary.
- (d) the technical qualification of the Agency's auditors, their adequacy to meet Agency audit objectives, and the adequacy of training and professional development.
- (e) management practices followed within the Agency's audit organizations, to determine whether staff are used efficiently and effectively.

### Determining Standards

Notwithstanding its special operating arrangements, CIA is part of the executive branch of government. Agency management has consistently stated that their intention is to conduct CIA operations as much like any other executive agency as possible, subject to the same constraints and objectives. For this reason, we sought to identify standards and regulations within the federal government that describe the functions to be performed through audit.

The Budget and Accounting Act of 1950 redefined the role of auditing somewhat, and provides the legal framework for auditing in the federal government. The United States General Accounting Office, a congressional agency, is the central audit authority in the federal government and, as such, exerts strong influence on internal auditing in executive agencies. The Office of Federal Management Policy, General Services Administration, prescribes



auditing policy for the executive branch (it was preceded in this function by the Office of Management and Budget). Finally, CIA's own enabling legislation and operating regulations define specifically, Agency management's standards.

We believe there are four sources particularly useful in determining federal internal audit standards. Chronologically they are as follows:

(1) A booklet entitled Internal Auditing: A Statement of Principles and Concepts, published by the General Accounting Office in 1957.

(2) A revision of the first GAO booklet entitled Internal Auditing in Federal Agencies: A Statement of Basic Principles and Concepts, published in 1968.

(3) A booklet entitled Standards for Audit of Government Programs, Organizations, Functions and Activities published by GAO in July 1972.

NOTE: The three booklets listed are not binding on executive branch agencies, but are suggestive of the standards applied by GAO in its evaluations of federal practices, and, more specifically, of internal audit organizations.

(4) Federal Management Circular 73-2, "Audit of Federal Operations and Programs by Executive Branch Agencies," dated September 27, 1973.

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Headquarters regulations [REDACTED] established CIA standards for internal audit.

As a final element of criteria, we used the experience we have gained in operating our own audit practice, both in the areas of administration and management and in technical performance.

#### Assessment of CIA Internal Audit Activities

CIA has two organizational elements that conduct audits, (1) the Inspector General's Audit Staff, and (2) the Commercial Systems and Audit Division of the Office of Finance. In our reviews of both elements we determined what audits they perform, how they went about their audits, and what results were produced. We examined a representative cross-section of recent audits in detail to determine (1) the adequacy and applicability of audit programs used, (2) the adequacy of evidence collection and presentation as represented by the audit working papers, and (3) the appropriateness of reports resulting from the audits.

The schedule on the following page lists the specific audits selected for review. In each case, we reviewed in depth the most recent audit available, and also audits of past years to evaluate consistency. Specific technical comments resulting from our reviews

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This report contains our observations resulting from comparison of the audit activities we reviewed with the standards which we believe are applicable.

## SUMMARY

Our review of the operations of the Agency's audit organizations has shown they perform a thorough audit at least annually of all the Agency's financial transactions, and provide management useful information concerning the efficiency and economy of some elements of Agency operations. The Audit Staff is generally well-trained, competent and well-organized, and occupies a position in the Agency management hierarchy that gives it independence in planning, programming, executing, and reporting on reviews of all Agency activities. We believe, however, a number of opportunities for improvement exist, including greater emphasis on program performance auditing, better use of management talent developed through participation in the Audit Staff activities, and improved quality control within the Audit Staff.

Our review of CSAD indicated they perform adequate audits of direct materials and labor charged to CIA contracts, but that some opportunities for improvements in quality control and efficiency are worthy of consideration. We also found indications that a shift in CSAD audit emphasis may enhance its effectiveness as an aid to the procurement process.

### Organization of this Report

For the convenience of the reader, we have organized our report into several sections. The first outlines areas in which we believe the Audit Staff's existing operations are satisfactory. The second outlines opportunities for improving Audit Staff operations and policies. The third section contains our observations on the operation of the Office of Finance's Commercial Systems and Audit Division. And finally, the appendices provide our specific comments on and suggestions for improving technical aspects of audit operations (we believe these sections will be useful mainly to the Chiefs, Audit Staff and CSAD). Some of the issues more fully developed in the report are:

### Areas of Satisfactory Performance

- the Audit Staff is organizationally independent and has a direct line of communication with the Agency Director.
- Agency management has been generally responsive to Audit Staff reports and findings and has taken corrective action where appropriate.
- the Audit Staff is generally well-qualified, well-trained, professionally competent, and, for the present, adequate in numbers. The Audit Staff training and development policy has encouraged its employees to remain abreast of current audit techniques and prepare for new areas of emphasis.

- financial and compliance audits are thorough and comprehensive
- the Audit Staff is well-prepared to audit ADP activities.

Opportunities for Improvement

- Agency policy presently emphasizes financial and compliance auditing. To conform to overall federal policy, and to more effectively use the staff resources available on the Audit Staff, Agency management should encourage audits of the economy, efficiency and effectiveness of Agency programs.
- closer coordination between the Inspections Staff and Audit Staff, particularly in program performance areas (economy, efficiency, effectiveness), would enhance overall management review.
- Agency management could capitalize on a ready source of management talent by considering upper level Audit Staff employees for management positions in operational areas. In addition to the primary benefit of gaining highly trained management talent, turnover incident to reassignment would provide continuing avenues for training and growth within the Audit Staff.
- an articulated policy for quality assurance, including independent working paper and report review, would help to insure sustained high quality of Audit Staff performance.
- a counseling program, if properly conceived and carried out, could help staff members better understand organizational goals and where they stand in relation to the organization.
- if the CIA audit policy requiring annual audits of all activities is changed, the continued operation of the Audit Staff's covert public accounting firm may be uneconomic.
- the Commercial Systems and Audit Division, Office of Finance, may be able to shift the emphasis of its audits somewhat to provide more useful information to procurement personnel. In addition, opportunities for improvement in evidence collection techniques and quality control are worthy of consideration.